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SUBJECT: IMF HINTS AT RETURN TO UKRAINE

REF: A. KYIV 581
[1](#)B. KYIV 576

Classified By: AMBASSADOR WILLIAM B. TAYLOR, REASONS 1.4 (B) AND (D)

[1](#)1. (C) Summary. The IMF is preparing to return to Ukraine in spite of Rada failures to pass needed spending cuts on March 31, according to its resident representative in Kyiv, Max Alier. Alier told us on April 1 that the IMF mission team would likely come back to Kyiv to engage in tough negotiations that would help prevent a further deterioration in Ukraine's economy. The April 1 Rada resolution to schedule presidential elections on October 25 "changes everything" for the Fund's expectations of Ukraine, said Alier. The IMF cannot anticipate serious implementation of conditionalities in Ukraine's current political environment without greater engagement, and it cannot let Ukraine fail, said the official. Having been pushed by shareholders -- including, he claimed, by parts of the USG -- to move forward, the mission would justify its return on the basis of Ukraine's current accomplishments and potential for finalizing outstanding elements of the program. If obtained, these may be enough to disburse the Fund's second tranche. The IMF is standing firm in its view that Ukraine will need bilateral budget support, even though it is considering the contours of an expanded program that would meet Ukraine's worsening external debt position and its fiscal gap. End summary.

Mission Team Preparing a Return

[1](#)2. (C) Based on IMF internal discussions and the agenda points for the IMF's principals meeting on Ukraine that took place in Washington on April 1, Kyiv-based IMF representative Max Alier told us that Ceyla Pazarbasioglu's mission team may decide to come back to Ukraine. (Note: As of April 2, we have not heard any update on whether a decision has been reached. End note.) Alier said that certain parties -- including elements of the USG -- have been putting pressure on the IMF board to bring the team back (see paragraph 8). "We are being told we can't let the program fail or stand by and watch Ukraine fall apart," noted Alier. He added that IMF managing director Dominique Strauss-Kahn is highly engaged in Ukraine matters, more so than is typical. "He's very interested and follows the details." Alier stressed that the mission team would not return to Kyiv if the Board was not prepared to disburse the second tranche of its \$16.4 billion Stand-By Arrangement (SBA).

IMF Tally of Ukraine's Accomplishments

[1](#)3. (C) The IMF board would have to justify disbursement of a second loan tranche, roughly equal to \$1.85 billion, by

adding up evidence of Ukraine's compliance with IMF conditionalities. Alier pointed to the fact that the Rada has passed politically risky changes to budget articles 84 and 86 (on monetizing debt and bank refinancing). The GOU has started on the bank recapitalization process, and there was now a bank recapitalization unit at the Ministry of Finance, he said. Additionally, Alier pointed to the fact that the leadership question at the National Bank had been clarified, even if Governor Stelmakh remained unpopular, and the Rada had passed legislation to boost revenues equivalent to 1 percent of GDP.

14. (C) In response to skepticism about Rada measures totaling 1 percent of GDP, Alier admitted, "Well, we've been generous in our calculations." He also acknowledged what Post has heard about the bank recapitalization process, namely that many administrative and political hurdles remain before banks can receive funds. Alier said that overall economic leadership and coordination remains a problem, especially in the absence of a Finance Minister, but he noted that PM Tymoshenko believes her party is unable to marshal majority votes in the Rada to approve cabinet-level appointees. BYuT MP Valeriy Pysarenko confirmed with us that the coalition has no current plans to introduce cabinet changes in the Rada, because they don't have the votes to ensure approval. Deputy Finance Minister Umanskiy has taken charge of the Ministry and, according to Alier, is close to Tymoshenko in all her IMF dealings.

Presidential Elections "Change Everything"

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15. (C) Alier noted that the April 1 Rada vote to schedule the presidential election on October 25 will "change everything" for the IMF program (Ref A). In the current political environment, there were diminishing hopes for RadaQ legislation to close the budget deficit without enhanced engagement, said Alier. (Note: Coalition parties jointly announced on April 2 their intention to take up remaining anti-crisis legislation on April 14. End note.) Tymoshenko will not risk anything in her desire to win the presidency, and all other political parties will be focused more on short-term agendas than on the IMF program. Any effort by the President to postpone the election will be worse for the IMF program, as it will delay the date the Fund "can start working again" to achieve hard compliance with conditionalities. The IMF now needs to turn its attention on keeping Ukraine afloat in the months up to the elections. Higher-level negotiations may be required to maintain focus on outstanding legislative measures on pension spending and the budget of state energy company Naftohaz. The IMF recognizes it may have to wait until after the election for more serious implementation of structural conditionalities and an expansion of the program, according to Alier.

Plugging the Fiscal Gap

16. (C) Alier stood by the IMF's oft-repeated message that bilateral budget support is critical for Ukraine as a "bridge" until after the election. When asked about channeling budget assistance through international financial institutions, Alier agreed that the IMF could alter its program to cover Ukraine's budget deficit, if given an impetus to do so by shareholders. But, he cautioned, "that is not a bullet you want to fire yet." The IMF will eventually need a larger package to meet increased external debt financing needs in any case, given Ukraine's worsening economic outlook. "You can't raise the level of the program twice" (i.e. once for budget support and a second time to address a worsening external debt position), especially if structural conditionalities were not being met, said Alier. The time to alter the IMF program would be after the presidential election, but until then Ukraine would still

need other sources to finance its budget hole. Alier confirmed that the Fund had sufficient resources to expand its Ukraine SBA, though it was now focusing efforts on a possible roll-out of large programs in Mexico and Turkey.

Relations with Tymoshenko, Yushchenko

17. (C) Alier offered commentary on his working relationships with Ukraine's leadership. He expressed frustration with Yushchenko, both for the failure of deputies loyal to the President to support anti-crisis proposals in the Rada on March 31 (Ref B), and because he had only seen the President five times since arriving in January. By contrast, Alier noted that he spends roughly 6-8 hours each week with Tymoshenko. He called her "hands-on, detail oriented, and a world class negotiator," referring specifically to her brokering of the latest set of IMF prior actions. Alier told anecdotes about brainstorming sessions. Deputy Prime Minister Turchinov, Deputy Finance Minister Umanskiy, and others floated in and out of the office, Alier said, while the Prime Minister remained focused. The meetings have become relatively informal, according to Alier, so much that Martin Raiser walked out of the April 1 discussions after two hours, saying he had another commitment. Alier could not believe Raiser's pluck. While Raiser was polite and didn't leave as a result of a dispute, "she's the Prime Minister!" Alier quipped.

Comment

18. (C) From his position outside of Washington, Alier has the impression IMF headquarters have received conflicting signals from the Treasury and State Departments of when the team should return. He said that the Treasury Department had determined to move "fast forward" on the mission team's return, while the State Department was more wary, waiting to see more action from the Ukrainians on IMF conditions. We surmise that this perception is a matter of policy accent rather than differing content.

19. (C) Although the Rada failed on March 31 to pass a full

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basket of measures to shrink Ukraine's 2009 budget deficit, Alier has indicated that the IMF may be prepared to come back to Ukraine to conduct serious negotiations. The United States should reinforce the critical nature of these talks through high-level engagement, including through visits, that stress the importance of swift Ukrainian actions to get the IMF program back on track.

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